STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 98-555

January 14, 1999

BANGOR HYDRO-ELECTRIC COMPANY
Affiliated Interest Transaction and Reorganization to Transfer its CareTaker Home Security Monitoring Business into a Separate Subsidiary

Order Approving Stipulation

WELCH, Chairman; NUGENT, DIAMOND Commissioners

I. SUMMARY OF DECISION

In this Order, we approve the Stipulation filed in this matter on behalf of Bangor Hydro-Electric Company and the Public Advocate. In approving the Stipulation, we allow Bangor Hydro-Electric Company (BHE or Bangor Hydro) to form a subsidiary, CareTaker Inc. (CareTaker), which will be wholly owned by BHE. CareTaker's sole purpose will be to own and operate a security and monitoring business for its own residential and commercial customers. We also allow BHE to invest up to $680,000 in CareTaker and approve a support services agreement allowing BHE to provide certain support services to CareTaker.

II. BACKGROUND

On July 17, 1998, BHE filed a Petition for Affiliated and Reorganization Approvals Needed in Connection with its CareTaker business. In its filing, BHE requested approval pursuant to section 708 of Title 35-A to form and participate in CareTaker, to invest $215,000 in cash to cover operational cash shortfalls at CareTaker during the 12-month period beginning with the filing and to transfer $177,135 in assets to CareTaker.[1] BHE also sought approval pursuant to section 707 of Title 35-A to enter into a support services agreement with CareTaker.

In our January 28, 1997 Order in *Robert D. Cochrane et al v. Bangor Hydro-Electric Company*, Docket No. 96-053, we required BHE to form a separate subsidiary to undertake its security alarm business which is a non-core activity. The Order also required BHE to file for approval of a reorganization and affiliated

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[1] Based on projected cash flows for CareTaker, BHE anticipates that it will need to make additional investments in CareTaker in subsequent years. It will seek approval for any additional investments. Petition at 3.

transactions in connection with the creation of a separate subsidiary for its CareTaker operation. 35-A M.R.S.A. §§ 707, 708. In addition, Chapter 820 of the Commission's rules took effect on August 14, 1998. These rules set forth requirements for utility participation in non-core activities such as BHE's CareTaker.

On August 7, 1998, the Examiner issued a Notice of Proceeding and Procedural Order requiring BHE to prefile testimony relating to its financial condition, its valuation for the use of its name by CareTaker, and its rationale for a request of a waiver of Section 5(B) of Chapter 820. On August 24, 1998, BHE filed the testimony of Frederick S. Samp. In that testimony, BHE indicated that CareTaker intends to use BHE's name in its promotions or advertisements and to charge CareTaker for using BHE's name in accordance with the formula stated in section 4(C) of Chapter 820. In addition, BHE requested that the Commission waive section 5(B) of Chapter 820 based on the financial information filed in the record in Docket No. 97-796 (*Bangor Hydro-Electric Company, Petition for Affiliated and Reorganization Approval Needed in Connection with Bangor Gas Company Transaction).*[2] BHE also indicated that it had, as of the date of the prefiled testimony, invested a total of $219,525 in CareTaker. Thus, as of August 24, 1998, BHE sought to invest a total of $611,660. In the course of this proceeding, BHE updated the total amount that it sought approval to invest. The Stipulation asks the Commission to approve a total investment in CareTaker of $680,000.

The Public Advocate and Central Maine Power (CMP) intervened in this case. The Public Advocate and the Commission's Advisory Staff (Advisors) issued data requests to which the Company responded. The Commission held two technical conferences. The Public Advocate, BHE and the Advisors participated in the conferences. To allow discussions between the Advisors and BHE to continue after the technical conferences, the Public Advocate and CMP agreed to an *ex parte* waiver. On December 7, 1998, BHE filed a Stipulation on behalf of itself and the Public Advocate. BHE represents that CMP has no objection to the Stipulation.

By the agreement of the parties, the record in this proceeding includes the Stipulation, all discovery materials, prefiled testimony, transcripts of technical conferences and the entire record in Docket No. 97-796, including testimony, the Bench Analysis, discovery materials and transcripts of technical conferences.

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[2] BHE later produced an updated financial forecast reflecting its agreement to sell its generation assets.

III. PROVISIONS OF THE STIPULATION

The Stipulation states the parties' agreement that:

- the Commission should approve BHE's creation of CareTaker, which will be wholly owned by BHE;

- the sole purpose of CareTaker will be to own and operate a security and monitoring business;

- the Commission should grant a waiver from section 5(B) of Chapter 820 to allow BHE to invest a total of $680,000 in CareTaker including amounts already expended on CareTaker, asset transfers, and amounts, including development costs, that the Company expects to invest in CareTaker during the period from July 1, 1998 to December 31, 1999;

- the Commission should grant a waiver (to the extent necessary) from section 4(A) of Chapter 820 to allow BHE to use the cost allocation methodology set forth in its cost manual to allocate the costs associated with BHE services and facilities that will be used by CareTaker;

- a waiver of section 4(A) is based on BHE's representation that CareTaker's use of BHE's services and facilities will be limited and will decrease after a transition period;

- the waiver may be revoked, after BHE has an opportunity to be heard, if CareTaker's use of BHE's services extends beyond the limited use represented by BHE;

- six months after the approval of the Stipulation, BHE will file a report at the Commission describing the extent of CareTaker's use of BHE's services and facilities;

- based on the waiver of section 4(A), BHE should be granted permission to enter into the Support Services Agreement filed in this matter;

- BHE's participation in CareTaker will be consistent with the requirements of Chapter 820 except for sections 4(A) and 5(B);

- BHE will use the methodology set forth in Chapter 820 to determine the value to CareTaker of using BHE's name;

- BHE will not enter into any arrangement with CareTaker other than those approved in this Docket, except if granted approval by the Commission;

- CareTaker will not lease any space from BHE without specific Commission approval except that BHE will be permitted to provide office and storage space during a 6-month transition period after the Commission approves the Stipulation; and

- the Commission will be provided reasonable access to CareTaker's books and records.

In addition, the Stipulation contains the following provision:

> BHE's ratepayers shall be held harmless from any and all negative consequences flowing from BHE's investment and participation in CareTaker, regardless of the prudence of BHE's actions in participating in CareTaker. Negative consequences include, but are not limited to, effects on cost of capital, cash flows, financial indicators, and financing costs (e.g., financing costs, higher than would have otherwise been the case for utility capital projects, financing costs [sic], buyouts of purchasing power contracts, or the pay-down of debt). In any proceeding that may affect rates or involve the issue of the financial condition of Bangor Hydro, Bangor Hydro shall have the burden of proof that ratepayers are held harmless. The parties further agree that the intent and purpose of this provision of holding ratepayers harmless shall not be hindered or compromised by an inability to quantify with precision the financial consequences to ratepayers of BHE's participation in CareTaker.

Stipulation ¶ 5. This provision is nearly identical to the ratepayer hold harmless language in the Stipulation in Docket No. 97-796 approved in our Phase I Order in that case. *See* Second Revised Stipulation ¶ 4(b), appended to Order Rejecting Stipulation and Approving Second Revised Stipulation, (Phase I Order), *Bangor Hydro-Electric Company Petition for Affiliated and Reorganization Approval Needed in Connection with Bangor Gas Company Transaction,* Docket No. 97-796 (March 26, 1998).

IV. DISCUSSION

A. Approval of Investment

1. Statutory and Regulatory Criteria

We have recently set forth the standards governing reorganizations of public utilities. In our Phase II Order in Docket No. 97-796, we stated:

> Section 708 of Title 35-A provides that no reorganization may be approved unless the applicant establishes that the reorganization is consistent with the interests of the utility's ratepayers and investors. Section 708 further states that in granting its approval for a reorganization, the Commission shall impose such terms, conditions and requirements as are necessary to protect the interests of ratepayers, including, in relevant part, provisions which ensure:
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> - that the utility's ability to attract capital on reasonable terms, including the maintenance of a reasonable capital structure, is not impaired;
> - that the ability of the utility to provide safe, reasonable and adequate service is not impaired;
> - that the utility's credit is not impaired or adversely affected; and
> - that reasonable limitations are imposed upon the total level of investment in non-core ventures.

Bangor Hydro-Electric Company, Petition for Affiliated and Reorganization Approval Needed in Connection with Bangor Gas Company Transaction, Docket No. 97-796, Order (Phase II) at 3 (October 30, 1998). *See also, Maine Public Service Company, Request for Approval of Reorganization Approvals and Exemptions and for Affiliated Interest Transaction Approvals,* Docket No. 98-138 Order at 2-3 (September 2, 1998) (MPS Order). In addition, section 707 of Title 35-A prohibits utilities from entering into agreements with an affiliated interest unless the Commission approves the agreement.[3] Section 713 of Title 35-A

[3] To approve an affiliated interest transaction, the

specifies that a utility may not charge its ratepayers for costs attributable to unregulated business ventures. *Id.*

Taken together, these statutory provisions require utilities entering into non-core ventures to demonstrate that ratepayers are insulated from any negative financial consequences that may result from a utility's participation in such non-core ventures.[4] MPS Order at 3. The Legislature also sought to preclude ratepayer subsidy of unregulated businesses, as well as any unfair competitive advantages that may result from an affiliation with a utility. 35-A M.R.S.A. § 713.

Chapter 820, which governs a utility's non-core activities and transactions between affiliates, implements the legislative policies and directives set forth in sections 707, 708 and 713. Section 5(B) of Chapter 820 provides, in relevant part: "No petition for affiliated interest or reorganization approval for a utility to invest in a non-regulated affiliated interest shall be approved if the utility's bond rating is below investment grade." MPUC Rules Ch. 820 § 5(B). Chapter 820 uses the utility's credit rating as the standard for allowing investments because such ratings are a reliable indicator, prepared by an independent entity, of a utility's financial health. MPS Order at 7, citing Order Provisionally Adopting Rule at 38, Docket No. 97-886 (Feb. 18, 1998). The rationale underlying section 5(B) of Chapter 820 is that a utility with a non-investment-grade bond rating is not financially sound and, as a result, there is a reasonable likelihood that the Commission would not be able to achieve its policy of protecting ratepayers from the consequences of a utility's participation in non-core activities. MPS Order at 4.

Chapter 820 also seeks to protect ratepayers from subsidizing non-core activities and to prevent unfair competitive advantages by establishing specific affiliate transaction and accounting rules. Section 4 of Chapter 820 requires utilities and affiliates to charge each other market rates for goods and service that are not tariffed. To the extent a market price is unavailable, Chapter 820 requires the utility to charge its affiliate based on a fully distributed cost methodology. MPUC Rules Ch. 820 § 4.

In addition, Chapter 820 allows for a waiver of any of the rule's provisions that are not required by statute upon a finding of good cause and that the waiver would not be

Commission must find that it is not adverse to the public interest. 35-A M.R.S.A. §707(3).

[4] Negative financial consequences of a utility's non-core investments may include increases in the cost of debt or equity.

inconsistent with the purposes of Chapter 820 or applicable statutes. MPUC Rules Ch. 820 § 9.

2. Requested Waiver of Section 5(B) of Chapter 820

The Stipulation states the parties' agreement that a waiver of Section 5(B) of Chapter 820 should be granted to allow BHE to invest $680,000 in CareTaker from the inception of the CareTaker business in 1995 through December 31, 1999. In our decision in Docket No. 97-796, we allowed BHE to invest $1.22 million in Bangor Gas. Granting the waiver and approving the proposed investment in CareTaker would increase the amount of BHE's total non-core investments to $1.9 million.

BHE does not currently have an investment-grade bond rating. BHE's most recent rating is Standard & Poor's private letter rating of BB.[5] Thus, unless a waiver of section 5(B) of Chapter 820 is granted, BHE would not be allowed to make the $680,000 investment.

We must determine whether there is good cause for the waiver and whether the waiver is consistent with the purposes of Chapter 820 and section 708 of Title 35-A. In so doing, we determine whether ratepayers can be insulated from the negative effects of the investment. We consider first whether BHE's financial condition is sound enough to make the investment even though it has not attained an investment grade bond rating. *Bangor-Hydro Electric Company, Petition for Affiliated and Reorganization Approval Needed In Connection with Bangor Gas Company Transaction,* Docket No. 97-796, Phase II Order at 5. (October 30, 1998), (Phase II Order). The reason for making this determination is that "unless the utility is in sound financial condition, it is impossible to insulate ratepayers from the negative consequences of an investment." Phase II Order at 2. We also consider ways to enforce our legislative and regulatory mandate that ratepayers shall not be subject to any increase in costs resulting from a utility's non-core investment.

a. BHE's Financial Condition

In our Phase II Order in Docket No. 97-796, we determined that:

> BHE's financial condition has improved since March 1998. By no stretch, however, can BHE

[5] *See* letter dated February 10, 1998, from Standard & Poor's to Frederick S. Samp, appended to BHE's supplemental filing of July 17, 1998, Docket No. 97-796.

> be viewed as so healthy financially that we should abandon our scrutiny over the size of its investments in non-core activities.

Phase II Order at 16. Since the closing of the record in Docket No. 97-796, BHE announced its agreement to sell most of its generation assets for approximately $90 million (about 1.5 times their book value). BHE subsequently submitted an updated forecast based on the anticipated generation asset sale. The updated forecast indicates that BHE's financial performance will improve as a result of the asset sale. Based on the updated forecast, it appears that the Company's financial indicators will likely be within the range necessary to attain an investment-grade bond rating within the next few years.

b. Insulating Ratepayers from Effects of Non-core Investments

Having considered the moderate size of BHE's cumulative non-core investments and BHE's improved financial condition, we find good cause for the waiver of section 5(B), as long as ratepayers are insulated to the maximum degree possible from the negative impact of BHE's non-core investments.[6] In a recent decision concerning Maine Public Service Company (MPS), we imposed, as a condition of allowing certain investments in unregulated activities, certain rebuttable presumptions concerning capital costs that would be employed in future rate setting proceedings. *Maine Public Service Company*, Docket No. 98-138, Order at 5-7. The purpose of these presumptions was to indicate how the Commission would determine whether the investment had adversely affected MPS's cost of capital to the detriment of ratepayers. While the logic we applied in our MPS decision would support the imposition of a similar "condition" here, we decline to do so. Instead, we describe below our current expectation of how we would, in a future proceeding, determine whether ratepayers had been harmed (through higher capital costs) by BHE's investments in unregulated activities.

The distinction between an MPS-type condition and an articulation of how we expect to address the issue of ratepayer harm is of minimal practical significance. The MPS condition itself does not finally resolve how we will determine the cost of capital for MPS, but instead establishes a

[6] In this regard, we note that we would expect that to avoid any increased interest costs that might result from a violation of the conditions of its agreement with its lenders, BHE would obtain any additional authorization it may need from its lenders before making the $680,000 investment in CareTaker.

presumption, rebuttable by MPS, that if the evidence shows that the cost of capital for MPS as a whole exceeds certain benchmarks, the "excess" cost is the result of unregulated investments and activities. Nevertheless, finding the rebuttable presumption approach especially problematic, BHE objects to the condition (to the point, which we do not credit, of suggesting that the condition might cause it not to proceed with the CareTaker investment). The Public Advocate also urges us not to impose such a "condition," noting that the particular investment for which approval is sought here is too small to justify what amounts to a general condition on all BHE investment in unregulated activities. Because we believe we can adequately protect ratepayers in this case without recourse to rebuttable presumptions and without characterizing our intentions as a "condition," we will impose only the general condition that ratepayers must be held harmless from any impact of the unregulated activities on cost of capital (as articulated in paragraph 5 of the Stipulation).

We will, however, put BHE (and, indeed, other utilities who are investing in unregulated activities) on notice that we will consider the benchmarks articulated in the MPS order to be relevant when we next examine cost of capital for BHE (and other utilities). It is likely that, in the absence of persuasive and specific evidence to the contrary, we will conclude that any deviation on the high side from the benchmarks is the result of unregulated activities, and will not be allowed in rates.

We cannot now say definitively what kind of evidence would be relevant to addressing this issue. By way of illustration only, proof that the investments, taken as a whole, were successful, low risk, or too small to matter, might (without suggesting that other kinds of evidence might not also be persuasive) support a deviation from the benchmark if more general evidence supported such a finding. Nor do we suggest that the benchmarks provide a "safe harbor" that would preclude a finding that ratepayers were harmed by the impact of unregulated activities on cost of capital even if the requested cost is below the benchmark. We merely indicate that we intend to use the benchmarks as a signal that the question of ratepayer harm due to cost of capital impacts of unregulated activities merits close examination, and that, in the absence of persuasive evidence to the contrary, the benchmark caps are likely to be adopted.

For the benefit of the parties, we outline below the specific benchmarks or caps referred to above:

1. For existing variable rate debt (either long or short term debt) on BHE's books, the benchmark will be the

current margin to the stated index[7] regardless of the Company's future circumstances. The reason for this benchmark is that it is common practice in negotiations regarding the breach of loan covenants for lenders to increase the margins they charge the borrower and also to impose additional fees.

2. The possibility of new fees and higher rates also exists with the Company's fixed-rate, long-term debt. The benchmark for each of BHE's fixed-rate, long-term debt instruments will be its current embedded cost rate.[8]

3. If BHE requires future debt issuances, the benchmark for such debt costs will be the prevailing rate applicable to investment-grade utility bonds (defined as having a rating not lower than BBB- from S&P, Fitch or Duff & Phelps, or Baa3 from Moodys). This benchmark would hold ratepayers harmless from paying higher interest costs if BHE requires future debt for utility purposes but is in a weakened state due to its participation in non-core activities.

4. We adopt a methodology to establish a benchmark for the Company's cost of equity using a variation of a risk premium approach to insulate BHE's ratepayers from changes in cost of equity due to investments in non-core ventures. Rather than using Treasury or other debt instruments as the benchmark to which an equity risk premium would be added, we will use an <u>industry-specific risk premium</u> for the foreseeable future. Specifically, we will calculate both the current cost of equity for a peer group of electric utilities comparable to BHE as well as the current cost of equity for an index of water utilities to determine an appropriate premium (if any) for the electric industry today versus the water utility industry. As part of BHE's ongoing proceeding in Docket No. 97-596 to establish transmission and distribution rates, we will determine an appropriate "electric industry" cost of equity margin for BHE. To determine a cap on the cost of equity for BHE, this margin would be added to the calculated result for the same index of water utilities at a point in the future when the question may arise. The water utility industry is our benchmark in this methodology because it is not currently undergoing substantial structural change and remains largely

[7] The current margin and index is the margin and index stated in the original loan document.

[8] The current embedded cost rate will be determined in Docket No. 97-596, the Commission's investigation into stranded cost recovery, transmission and distribution revenue requirements and rate design for BHE.

> a monopoly service. It is reasonable to compare the future T&D utility industry to the water utility industry today. Therefore, the water industry appears to be a good proxy for the T&D utility industry for the foreseeable future. If future structural changes in the water industry invalidate this comparison, we will revisit this position. For the time being, however, this methodology would capture changes in the capital markets that would have an impact on "pure utilities."[9]

Further, we observe that, in general terms, we interpret the "ratepayer hold harmless" provision in the Stipulation to require BHE to demonstrate in a rate proceeding that no part of a rate increase is caused by its non-core investments.[10] If BHE cannot make such a showing, we will reduce the amount of the rate change accordingly to ensure that ratepayers have been insulated from the investments.

If the portion of a requested rate increase attributable to the non-core investment cannot be readily determined, we will approximate an amount based on any available information.[11] Ratepayers will not be required to pay for any additional interest costs resulting from a debt covenant violation that is caused in whole or in part by the non-core investments, and rates will not be increased to maintain or place the utility in compliance with its debt covenants if the violation or potential violation is a direct or indirect result of the investments.

B. Support Services Agreement

The Stipulation states the parties' agreement that the Commission should grant a waiver (to the extent necessary) of section 4(A) of Chapter 820 and approve the Support Services agreement filed by BHE in this matter. The Support Services Agreement lists numerous services that may be provided to

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[9] In the future, if a sufficient number of "pure" T&D electric utilities emerge, we may adopt methodologies that use those utilities directly, rather than our present choice of the water companies plus the predetermined margin.

[10] Because of the difficulty of isolating any negative effect of BHE's investment in CareTaker from the negative effect of BHE's cumulative non-core investments, we will consider the combined effect of all of BHE's non-core investments.

[11] BHE will have both the burden of production and burden of persuasion in such proceedings.

CareTaker by BHE and also provides that charges for the use of such services will be determined as follows:

> (1) If the service is a tariffed service it shall be provided at the tariffed rate; (2) If the service is one of which there is a readily available market rate, such service shall be provided at the market rate; or (3) If the service is one for which either (1) or (2) above do not apply the service shall be provided on a fully distributed cost basis.

Support Services Agreement, Article II, ¶ 1.

In addition, BHE has indicated that it will use the methodology set forth in Chapter 820 to determine payments that will be made by CareTaker to BHE for CareTaker's use of BHE's name. BHE has represented that it intends that CareTaker will have its own employees and office space after a transition period and that it expects that BHE employees will be used by CareTaker in a limited manner during a 6-month transition period. During the transition period, CareTaker is expected to use approximately 270 labor hours of BHE employees; BHE anticipates that CareTaker will be charged approximately $6,750 for the use of BHE's services during the transition period. BHE has represented that after CareTaker has its own space and employees, CareTaker's use of BHE employees will decrease.

BHE has submitted a copy of its cost allocation manual in this proceeding. Having considered the information provided by BHE in support that manual, it is not clear that BHE's methodology for assigning direct and indirect costs to CareTaker is consistent with section 4(A) of Chapter 820. However, we agree with the parties that there is good cause for the waiver. CareTaker's use of BHE's resources is expected to be very limited, and therefore, the dollar amounts at issue are very small. In addition, the Stipulation's reporting requirement will allow us to determine, on an ongoing basis, whether a waiver of section 4(A) of Chapter 820 continues to be appropriate. Further, the Stipulation's revocation mechanism provides a safeguard if the report shows that the use of BHE facilities and services by CareTaker is greater than expected.

Accordingly, based on the representations and conditions set forth in the Stipulation, we find good cause to grant a waiver of section 4(A) of Chapter 820 and will allow BHE to use its cost allocation methodology to allocate costs associated with CareTaker's limited use of BHE facilities and services. In addition, we find that, based on the representations and safeguards set forth in the Stipulation, the Support Services Agreement is not adverse to the public interest and we, therefore, approve it. 35-A M.R.S.A. § 707.

Accordingly, we

O R D E R

1. That the Stipulation filed on December 7, 1998 and appended hereto as Appendix A is hereby approved;

2. That BHE is authorized, pursuant to 35-A M.R.S.A. § 708, to form CareTaker, Inc., for the purpose of owning and operating a security and monitoring business;

3. That BHE is authorized to invest up to $680,000 in CareTaker, Inc. consistent with the terms of the Stipulation; and

4. That BHE is authorized, pursuant to 35-A M.R.S.A. § 707, to enter into the Services Agreement filed in this matter upon the terms set forth in the Stipulation.

Dated at Augusta, Maine this 14th day of January, 1999.

BY ORDER OF THE COMMISSION

Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
Nugent
Diamond

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. <u>Reconsideration</u> of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.

2. <u>Appeal of a final decision</u> of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320 (1)-(4) and the Maine Rules of Civil Procedure, Rule 73 et seq.

3. <u>Additional court review</u> of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320 (5).

<u>Note:</u>The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.